CBA | CONSUMER BANKERS ASSOCIATION

April 8, 2008

Jennifer J. Johnson
Secretary
Board of Governors of the Federal Reserve System
20th Street & Constitution Avenue, N.W.
Washington, DC 20551
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Re: Regulation Z; Docket No. R-1305

Dear Ms. Johnson:

The Consumer Bankers Association (CBA) [1] is pleased to submit the following comments on the proposal to amend Regulation Z, which implements the Truth in Lending Act and the Home Ownership and Equity Protection Act (HOEPA).

General Comments

CBA strongly supports the Board's efforts to use its regulatory authority to protect consumers in the mortgage market. The Board has done an excellent job of analyzing the problems that have led to the current state of affairs and to target the proposal to the most important factors. Although we disagree on a few particulars, we are pleased to see the issues being addressed in a targeted manner, carefully calibrated to balance the need for more regulation with a minimum of disruption to the market.

The goal of the proposed rules is to balance the protection of consumers with the unnecessary application of burdensome regulation, so that the benefits outweigh the costs. Thus, it is best to apply the principle of Occam's razor, such that, all other things being equal, the simplest solution is the best. This is not an argument for less regulation, necessarily, but for better regulation; and we appreciate the Board's recognition of the importance of this principle.

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[1] The CBA is the recognized voice on retail banking issues in the nation's capital. Member institutions are the leaders in consumer, auto, home equity and education finance, electronic retail delivery systems, privacy, fair lending, bank sales of investment products, small business services and community development. The CBA was founded in 1919 to provide a progressive voice in the retail baking industry. The CBA represents over 750 federally-insured depository institutions in the United States.

It appears that the cause of much of the economic turmoil in recent months can be laid at the feet of the characteristics of certain--though by no means all--higher-priced loans (i.e. loans more or less corresponding to the subprime market). While prime loans and so-called Alt-A loans may be facing some of the same problems in the market, these problems are more commonly the result of declining real estate values and tightening credit, and less commonly the result of any underlying failure of the lending or borrower characteristics. The impact on these borrowers has also been less severe and their ability to recover will be greater. Therefore, we support the decision of the Board to focus much of the proposal on higher-priced loans, rather than on the entire market.

We agree with the Board on the need for certainty during the application process regarding whether a particular loan transaction will be subject to a particular rule. As discussed more fully below, we believe that the proposed rule falls short in this regard. Our particular concern is the measure of higher-priced loans subject to some of the new requirements. We believe it is both the wrong measure and one that cannot be determined with certainty early enough to prevent violations.

We would like to stress one principal the Board should adhere to as it promulgates these rules: The liability for violations should be reasonable and proportional to the harm caused. Excessive liability will result in higher costs for consumers and reduced availability of credit. Applying this principal here, we believe the liability associated with violations of the HOEPA rules is disproportionate and unreasonably severe for all but the most egregious faults and would have adverse unintended consequences if adopted as proposed. Alternatively, we therefore recommend that, wherever possible, the new regulatory requirements be promulgated under the civil liability of section 105(a) of TILA, rather than section 129.

Uniformity

In May 2007, CBA joined with other industry trade associations, in endorsing a Statement on Responsible Subprime Lending. In that document, CBA stated, "Consistent regulation and uniform standards for all originators is essential to safe underwriting and protection for consumers. Any action taken by policymakers should involve all participants. Such action should establish a single uniform national standard that will provide consistent protections to consumers in all 50 states and U.S. territories. A national uniform standard should provide fair and consistent application to both bank and non-bank mortgage lenders."[2]

We have long advocated for better regulation of lenders not subject to federal supervision, in order better to protect consumers and to level the competitive playing field. This has the added advantage of creating a uniform marketplace for consumers who are shopping for credit, allowing them to compare terms and better protecting them

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[2] Statement on Responsible Subprime Lending [undated] ("Industry Statement"). http://www.cbanet.org/files/FileDownloads/CommentLetters/Joint%5FTrade%5FSubp%5FStatmnt%5Ffinal.pdf

from predatory practices. Since the regulated financial institutions are already subject to much more rigid standards, by virtue of numerous existing compliance guidelines, most notably the interagency Statement on Subprime Mortgage Lending (the "Subprime Statement")[3], these rules will apply similar rules to other lenders. We are grateful that the Board has done so in this proposal.

Liability

Most of the Board's Proposal is promulgated under authority of Section 129(l)(2) of TILA. That adds substantial additional liability risk to lenders. Consumers under that section may recover: (i) Actual damages; (ii) statutory damages in an individual action of up to $2,000 or, in a class action, total statutory damages for the class of up to $500,000 or one percent of the creditor's net worth; all of which are the standard liabilities for TILA violations under section 105. But in addition, consumers who bring an action under section 129 may recover *all finance charges and fees paid by the consumer*, unless the creditor demonstrates that the violation is not material. Further, state attorneys general have the authority to enforce these Section 129(l)(2) provisions, unlike violations of provisions that are promulgated under Section 105(a).

We believe these remedies are excessive and unnecessary for most of the provisions being proposed. The remedies for violations of TILA are more than adequate to ensure compliance. Our principal concern is that the penalties may be so harsh that creditors may flee the marketplace of higher-priced mortgage loans entirely—or cover the excessive risk with higher rates—ultimately harming consumers.

Therefore, throughout our substantive comments, we recommend that the Board seek ways of mitigating the harshness of the liability. To the extent it is within the Board's authority, we suggest that provisions be promulgated under Section 105(a). Liability for violations of provisions promulgated under this section is more than adequate to protect consumers and ensure that creditors place an appropriate level of attention on compliance. For those provisions that cannot be promulgated under Section 105(a), we urge the consideration of other means to ensure that minor, inadvertent, and technical violations of law do not result in draconian liability for lenders. TILA caused an epidemic of litigation in its early days, which was stilled by the passage of the Truth in Lending Simplification and Reform Act. We do not wish to see a new era of excessive litigation, at the expense of consumers, creditors and the mortgage markets.

We also recommend exempting from the coverage of the rules applicable to higher-priced mortgage loans federally regulated financial institutions that are subject to substantially similar requirements. It is widely acknowledged that depository institutions have not been the source of the problems this proposed rule is intended to address, and they are subject to comprehensive and extensive federal banking regulatory agency oversight. One example, described in our comments below, is the current requirement for national banks set forth in the rules of the Office of the Comptroller of the Currency (OCC). OCC

[3] http://www.federalreserve.gov/newsevents/press/bcreg/bcreg20070629a1.pdf

regulations, promulgated under the National Bank Act, prohibit a national bank from making any mortgage loan "based predominantly on the bank's realization of the foreclosure or liquidation value of the borrower's collateral, without regard to the borrower's ability to repay the loan according to its terms." 12 CFR 34.3(b). Thus, it is not necessary for national banks to be subject to a comparable rule under Regulation Z for there to be a level playing field. We recommend that the Board acknowledge this exemption, and further provide that the rules adopted pursuant to this Proposal apply to depository institutions only if the depository institution is not subject to a substantially similar requirement from its primary federal banking regulator.

Substantive Comments

<u>I. Proposed Definition of "Higher-Priced Mortgage Loan"</u>

A. Exclusion of HELOCs

We strongly agree with the Board's conclusions that home equity lines of credit (HELOCs) do not belong within the coverage of this proposed rule. As the Board states, most HELOCs are held in portfolio, rather than sold, which aligns the originators' interest in loan performance more closely with the consumer's interest. Further, Regulation Z already provides special protections for HELOCs, such as restrictions on changing the terms. Finally, HELOCs tend to be originated by federal financial institutions that are regulated and examined by the federal regulatory agencies, where they can be closely supervised and monitored for disclosure and underwriting.

B. Proposed APR Trigger for section 226.35

1. Need for a consistent standard among regulations

The Proposal would impose a threshold of 300 basis points above comparable Treasury securities for first-lien loans, or 500 basis points for subordinate-lien loans. This is close but <u>not identical</u> to the approach to identify loans that are over the Home Mortgage Disclosure Act (HMDA) threshold. For example, the determination of comparable Treasury securities is different and the timing requirements are different. We urge you to adopt one standard measure for both in order to reduce the complexity and burden of compliance by lenders.

Requiring two different calculations will require lenders to program more than one system with similar but not identical criteria. The cost will be excessive and unnecessary, and the possibilities for errors enormous. We do not see any good reason to maintain two such independent requirements, and we strongly recommend that the standard adopted here become the standard for HMDA as soon as possible—preferably in time for the 2009 HMDA data.

2. Proposed Thresholds

We agree with the Board that most of the problems it is addressing are in the higher-priced loan market. As the Board states, the subprime market is, by definition, the market with the highest credit risk. It tends to have less transparency, and borrowers tend to be less financially sophisticated and under greater financial stress. In short, it is where the need is greatest. On the other hand, most prime and alt-A lending is made by federal financial institutions that are under supervisory guidance from the federal regulatory agencies. In addition, much of the Proposal mirrors examination guidance and regulation already in place for national banks, federal thrifts, and other federally supervised financial institutions.

The placement of the coverage threshold is critical. It should be located at a level that mirrors as much as possible the level that most banks and thrifts consider subprime and—most importantly—cover as little prime and Alt-A lending possible. In this, we agree with the Board. However, the Board's stated goal is to *cover as much subprime lending as possible, even at the expense of covering too much prime and Alt-A lending*. Our members are concerned that the benefits of this approach to consumers could be outweighed by harmful consequences.

If there were a clear demarcation between subprime lending and all else, such that we could say that coverage of 100% subprime can be determined with 100% accuracy, it might be desirable to err on the side of covering too much, being comforted by the knowledge that all the subprime loans are within the confines of the rule. However, the concept of subprime is a fluid and ill-defined one; and there is no clear division between subprime and other loans using a simple measure such as APR. Every lender uses a different measure, relying on a variety of different factors—including FICO scores, loan-to-value ratios, debt-to-income, and other considerations --not easily put into a formula. The Board needs to understand that, by setting the rate threshold for the rule, it is creating a definition of subprime, not attempting to locate one. In effect, the Board's measure becomes the national *de facto* measure of subprime.

Many of our member banks do not consider that they are subprime lenders, and do not wish to be considered subprime lenders by others, yet they may make some loans that cross a rate threshold that the Board is proposing to create. We believe that for two reasons, many of these lenders will change their practices to avoid making loans over the Board's threshold, thereby reducing the availability of credit in some markets. First, they would wish to avoid the additional compliance costs driven by the extreme liability that might arise from even minor, technical violations. Second, some of them may not want to carry the onus that has increasingly become attached to subprime lending. In other words, they are concerned about a repetition of lenders' experiences with high cost mortgage loans, where the combination of the liability and the stigma associated with the product kept many lenders out of the market entirely.

We believe the Board's proposed threshold of 300 and 500 basis points over Treasuries of comparable maturity will pick up some of this lending that banks may not consider subprime, and a good deal of Alt-A and prime lending as well. According to our members, the spread over Treasuries of comparable maturity needs to be at least 400 basis points for first liens and 600 basis points for subordinate liens, to ensure that changes in the yield curve over time do not pull in a large number of Prime and Alt-A loans.

We are also concerned with the use of Treasuries as an index. Treasury securities are not generally employed as an index by lenders when they price mortgage loans. Thus, the changing securities rates do not go hand in hand with the changes in mortgage rates. Over time, the percent of subprime lending that is reported will inevitably rise and fall as the differences between mortgages and Treasury rates vary.

The Board should consider an alternative that makes use of an index better reflective of the indices that actually help determine mortgage pricing, e.g. the Freddie Mac 30-year conventional loan rate, currently published in the Board's H.15 Bulletin Selected Interest Rate Statistical Release, or a similar Fannie Mae rate. If the Board does make use of such an index, it may wish publish a comparable index of its own devising in order to protect against basing the regulatory coverage on an index that is privately generated. In any case, we suggest that it be published by the Board weekly for use by creditors making determinations about pricing thresholds.

In the event that the Board continues to rely exclusively on Treasuries of comparable maturity plus a spread for the definition of a higher-priced mortgage loan, we would recommend that an additional 100 basis points be added, such that the spread would be 400 basis points for first liens and 600 basis points for subordinate liens.

Our members have expended considerable effort during this rulemaking to examine various alternatives and how they would affect coverage, and we appreciate the Board's willingness to consider their recommendations.

3. Timing Requirement

The Board must also choose the threshold conservatively, because of the creditor's difficulty of knowing who is covered at the time an application is submitted. Since the final APR of the loan is often not known until the loan has been underwritten, and, if the rate is not locked in, may not be known until closing, creditors will have to build in a cushion by setting a threshold lower than the regulatory threshold. Thus, the spread needs to be still greater—how much greater is hard to say—to reflect the reality of the marketplace.

We therefore recommend that the Board (i) use the application date to set the index value; and (ii) provide a tolerance of 1/8% for the threshold determination. That should help minimize cases where the creditor incurs liability caused by changes between application and consummation.

II. Proposed Rules for Higher-Price Mortgage Loans

A. Ability to repay

1. National Banks

The Board's proposal would prohibit a lender from "engaging in a pattern or practice of making higher-priced mortgage loans based on the value of the consumer's collateral without regard to consumers' repayment ability as of consummation, including consumers' current and reasonable expected income, current and reasonably expected obligations, employment, and assets other than collateral." We support this provision. In the 2007 Industry Statement, CBA stated, "Regulatory action…should be based on several key principles: Lenders should only make home loans to consumers with subprime credit whom they reasonably believe have the ability to repay the loans based on information available at the time the loan is made." Although we were speaking in generalities, and not in the language of regulation that calls for a careful balancing of factors, we continue to endorse this fundamental principal.

This would not be a new requirement for national banks. On January 7, 2004, the OCC amended its rules under the National Bank Act to provide an additional layer of protection for consumers. One provision spells out what was already in agency guidelines – that a national bank may not make consumer loans based predominantly on the foreclosure or liquidation value of the borrower's collateral, without regard to the borrower's ability to repay the loan according to its terms. This placed a total ban on any lending by a national bank that does not take into consideration the borrower's ability to repay.[4]

In keeping with our overall call for a uniform set of standards applicable to banks and nonbanks alike, we support the inclusion of this requirement in the regulation. However, we strongly recommend that the Board state that compliance with substantially similar standards adopted by a federal regulatory agency satisfies the requirements of this rule. Thus, this "ability to repay" standard would apply to depository institutions only if the institution is not subject to a comparable requirement from its primary federal banking regulator, such as the current OCC rule.

2. Pattern or practice

[4] All the bank regulatory agencies soon issued a similar statement for subprime mortgage lending. In June 2007, the Subprime Statement said: "Prudent qualifying standards recognize the potential effect of payment shock in evaluating a borrower's ability to service debt. An institution's analysis of a [subprime] borrower's capacity should include an evaluation of the borrower's ability to repay the debt by its final maturity at the fully indexed rate, assuming a fully amortizing repayment schedule." [Footnotes omitted] http://www.federalreserve.gov/newsevents/press/bcreg/bcreg20070629a1.pdf.

The “pattern or practice” requirement is intended to reduce the risk of litigation while helping to prevent originators from making unaffordable loans on a scale that would cause consumers substantial injury. Whether there is a pattern or practice is supposed to be considered based on the totality of the circumstances.

We agree with the Board’s view that applying this principle to individual instances would invite nuisance litigation. However, the phrase “pattern or practice” has been used in other circumstances to refer to very few instances, such that without further clarification, we are concerned that the protections that the Board intends would be lost. We therefore recommend that the Board define what constitutes a pattern or practice in this instance as being based on a totality of the circumstances, and clarify that an occasional error would not normally constitute a pattern or practice.

3. Safe Harbors

The Board would provide a safe harbor regarding the determination of repayment ability for the life of the loan, where the creditor has a reasonable basis to believe that consumers will be able to make loan payments for at least seven years, considering all appropriate factors. The Board solicits comment on whether this is an appropriate amount of time. Although we support the safe harbor, we do not believe the amount of time is appropriate. Our members report that the average life of a subprime loan is two to four years. We therefore suggest that a more appropriate time frame for a safe harbor would be no longer than five years. We also recommend that the safe harbor be reversed: The creditor should be in compliance with this requirement if it has *no* reasonable basis to believe that the consumer will be *unable* to make loan payments for at least five years. The burden of proof should not be on the creditor to show that it was able to foresee the consumer’s income and assets so far into the future.

We recommend the addition of a safe harbor for loans that have met the automated underwriting standards of Fannie Mae and Freddie Mac. These are very widely used by creditors, yet are essentially “black boxes” to creditors. We therefore suggest that creditors be given an additional safe harbor for the use of the GSE automated underwriting systems.

4. Debt-to-Income Ratio & Residual Income

We support the Board’s decision not to create a mandatory debt-to-income ratio or residual income. As the Board notes, these are but two of many factors that determine repayment ability. Other factors (such as LTV or credit score) can mitigate these factors. To mandate a DTI or residual income would be unduly restrictive and would not be beneficial to consumers.

5. Current and Reasonably Expected Income

The Board proposes to retain references to expected and current income in determining a consumer's repayment ability, and to clarify that the expectations must be reasonable. We agree that consideration of expected income can be beneficial to consumers in many circumstances. The Board should clarify that taking reasonably expected income into consideration is permissive, not mandatory. Creditors should not have to get into disputes with consumers over what constituted reasonably expected increases (or decreases) in income. In any case, it is in the interest of the creditor to consider reasonably expected future rises in income; therefore, a mandate should not be necessary. Furthermore, a requirement to consider expected declines in income, however, could raise issues of age and retirement, with the potential for conflicts with Regulation B.

6. Other Proposed Clarifications

We are concerned about the addition of the requirement to consider not just existing obligations, but also "*reasonably expected obligations*." If, for example, a consumer buying a home speaks of the eventual desire to obtain a equity loan, buy a car, send his or her children to college using a student loan, or any other life goals, at what point does a creditor have some need to consider this as "reasonably expected obligations"? It is true that this requirement is mitigated somewhat by the "pattern or practices" element, but creditors must develop policies for loan officers; and we do not want to encourage policies that stifle communication between the lender and the consumer out of an abundance of caution. Therefore, we would suggest that the Board eliminate the reference to "expected" obligations, as it will cause confusion.

We understand the Board's suggestion that creditors making first mortgage loans should have to take "piggyback" loans (simultaneous home equity loans) into consideration as they determine ability to repay. However, simultaneous seconds should be differentiated from possible future indebtedness.

Regarding simultaneous obligations, we have one additional, practical concern. Creditors are sometimes victimized by fraudulent practices involving multiple simultaneous obligations. Creditors have in place procedures to try to minimize these occurrences, but the difficulty of obtaining instant records sometimes makes this fraud possible. We recommend that the Board either limit this requirement to simultaneous obligations entered into with the same or an affiliate creditor, or provide a safe harbor for the maintenance of procedures intended to prevent consumers obtaining a loan from another lender without creditor's knowledge.

B. Verification of Income and Assets Relied on (Documentation)

1. General

The Proposal would prohibit creditors making higher-priced mortgage loans from relying on amounts of assets or income, including expected income, in extending credit unless the creditor verifies such amounts. Only information being relied upon must be verified.

The Board has indicated that this is intended to be flexible in application, and that the only documents categorically excluded from use as verification is a statement only from the consumer. Examples of third party documents that may be used include W-2 forms, tax returns, payroll receipts, bank records, check cashing receipts, or a written statement from the consumer's employer. The Board also notes that creditors may adjust their underwriting standards for consumers who for legitimate reasons have difficulty documenting their income, such as the self-employed or those with irregular incomes.

In general, we support this requirement for higher-priced mortgage loans. [5] We also believe the flexibility that the proposal grants is warranted to reduce the risk of harm to those borrowers who are not in traditional wage-earning jobs. But we agree with the Board that there will be a cost for creditors as well as consumers, should this proposal be adopted. The Board seeks suggestions of narrower alternatives that would impose fewer costs while providing sufficient protection to consumers.

Since the proposal is clear that creditors can rely on assets other than collateral rather than income, [6] consumers who cannot document income but who have sufficient assets should also be permitted to document those assets in place of income. In addition, provisions should be made to permit oral information, such as an interview with an employer, where necessary.

We recommend that the Board create appropriate exceptions from coverage for certain loans. These may include, for example, loans with particularly low CLTV ratios or particularly high credit scores, or refinances where the monthly payment will not be increased over the borrower's prior payment amount, and the consumer's financial condition has not deteriorated (a mitigating factor described in the Subprime Statement).

2. Safe Harbor

The Board has created what the proposal refers to as a "safe harbor" for creditors who fail to verify income or assets before extending credit, if they can show that the amounts of the consumer's income or assets relied on were not materially greater than what the creditor could have documented at consummation. Thus, a creditor who may have failed to verify and document all income or assets relied on at consummation would have a complete defense to a violation of this requirement if, had it documented the information relied on at consummation, it would have been sufficient. Although most creditors will not be able to rely on this safe harbor as a matter of policy, we agree that it could help to prevent nuisance law suits, and will prevent a rigid application of the rule from standing in the way of a flexible loan process.

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[5] The Subprime Statement includes the following regarding documenting information on which the creditor is relying: "Recognizing that loans to subprime borrowers present elevated credit risk, institutions should verify and document the borrower's income (both source and amount), assets and liabilities." *P. 12.* However it also notes that mitigating factors may come into play.

[6] "For consumers who do not have a current income and cannot demonstrate a reasonable expectation of income, creditors may consider assets other than the collateral." 73 FR 1671, 1688 (Jan. 9, 2008)

3. Subordinate-Lien Loans

The proposal covers both first lien and subordinate lien loans. The Board requests comment on whether the proposal should make an exception for all subordinate-lien loans or those in amounts less than some specified dollar amount or percentage of the home value. The Board notes that this may in some cases increase costs without providing any appreciable benefit in consumer protection. As noted above, we believe the Board should consider exceptions for loans with particularly low CLTV ratios or particularly high credit scores, or refinances where the monthly payment will not be increased over the borrower's prior payment amount, and the consumer's financial condition has not deteriorated.

C. Prepayment Penalties

1. General

The Board's proposal would extend the current HOEPA restriction on prepayment penalties to higher-prices loans. Under those restrictions, a penalty is not permitted unless: the consumer's DTI at consummation does not exceed 50%; prepayment is not made using funds from a refinancing by the same creditor or an affiliate; the penalty term does not exceed five years from loan consummation; and the penalty is not prohibited under other applicable law.

The proposal would add the requirement that penalties expire at least sixty days before the first date, if any, on which the periodic payment amount may increase under the terms of the loan.

We believe sixty days is adequate for consumers in most cases to seek alternative financing prior to a payment increase. [7] However, as worded, the Proposal would appear to require the penalty to be lifted 60 days prior to *any possible payment increase*, even an annual increase that results from a rate increase on a one-year adjustable rate mortgage. Prepayment penalties can serve a useful purpose in keeping overall costs down for the consumer, because they provide some greater certainty for the investor. If the penalty is fully and clearly disclosed, it should be a legitimate pricing mechanism for creditors, and would not be unfair or deceptive, particularly given the requirement that the creditor underwrite the loan as mandated by the Proposal. The difficulty for the consumer, if any, would not be the possible payment increase at the end of each year due to a rate increase (which is often capped in any event), but the large increase that almost certainly will occur at the end of the initial term of a 2-28 or 3-27 hybrid ARM. We therefore recommend that the Board clarify that the 60-day period should be before a substantial payment increase, such an increase of 15% over the previous payment.

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[7] Since June, 2007, banks and other federally regulated depository institutions and their affiliates have already been subject to a similar requirement for subprime lending under guidelines in the Subprime Statement, where it says: "The applicability of prepayment penalties should not exceed the initial reset period. In general, borrowers should be provided a reasonable period of time (typically at least 60 days prior to the reset date) to refinance without penalty." (footnote omitted) *p. 14.*

Under the proposal, there would be multiple overlapping restrictions to protect the consumer (in addition to the TILA disclosure). First, the creditor would have had to underwrite the loan based on an ability to pay at whatever the highest payment might be up to the time designated in the rule. The consumer would not find himself facing payments he could not afford. Second, penalties would have to expire sixty-days prior to any payment increase. Thus, we would recommend some additional flexibility for creditors. In particular, we propose that the 50% DTI restriction be eliminated. There are many markets where the cost of housing would make it particularly difficult to meet this requirement, taking away from these consumers' options available to others. Also seniors and others with higher assets and lower fixed incomes would be disproportionately harmed. As noted, the other protections accorded by the proposed rule would prevent these consumers from being harmed by any excesses.

Finally, we note that the fact of a prepayment penalty is required to be clearly and conspicuously disclosed in the "Federal Box" under the Regulation Z disclosures, and with the proposed extension of the early disclosure mandate, this will be available to consumers early enough to make use of it when shopping for credit. If the Board believes that this disclosure needs to be improved, it can do so in the upcoming Regulation Z review rulemaking.

D. Requirement to Escrow

1. General

The Board is proposing to require higher-priced loans secured by a first lien to have an escrow account for property taxes and homeowners' insurance. Creditors, at their option, may allow a borrower to opt out of the escrow requirement, but only twelve months after consummation. We believe that the requirement to escrow for taxes and insurance is not necessary, and will impose an undue cost that would not be in the best interest of consumers.

The issue of escrows is fundamentally different from the other three restrictions being proposed for higher-priced mortgage loans. The others are attempts to protect consumers from taking excessive risks—intentionally or otherwise: i.e. borrowing more than they can reasonably repay if conditions are not favorable. Those who most need protecting are those with the least financial cushion to weather bad times. This section of the proposal, however, is intended to protect consumers from the most basic form of financial misjudgment, obtaining a loan that they cannot repay—considering principal, interest, taxes and insurance—from the start.

Many consumers prefer the financial benefits of not having to escrow for taxes and insurance, and creditors should be permitted to offer them that option where possible. Mandating escrows (for the first 12 months) is made unnecessary by the requirement in the Proposal to underwrite based on an ability to repay—taking into consideration taxes and insurance payments. If the consumer is unable to make the payment for the first year due to the taxes and insurance requirement, it would generally be because the creditor failed to comply with the ability to repay requirement. This is therefore belt and suspenders. If the Board believes that disclosures are inadequate, they can propose revisions in the upcoming closed-end credit review of Regulation Z.

If the Board does choose to adopt a mandatory escrow requirement, we recommend that the initial requirement to escrow should be tailored to more narrowly apply to first time homebuyers obtaining higher-priced mortgage loans. More experienced consumers should be allowed to choose not to escrow, provided they have been given full disclosure of the options.

We also recommend certain additional targeted exemptions from coverage. These are:

- Condominium loans, as these do not typically escrow for insurance, as this is usually paid by the condominium

- Cooperative loans, where both taxes and insurance are usually paid by the co-op

If the provision is adopted as proposed, we do support the flexibility accorded in the Proposal which allows creditors to permit consumers to opt out after twelve months. However, we would not support requiring creditors to do so.

2. Implementation Period

Since many lenders will have to begin compliance with escrow requirements for the first time, we strongly recommend that creditors be given an extra long lead time to begin compliance with any additional mandatory escrow requirement. We recommend that the delayed effective date for this provision be at least 18 months after publication of the final rule.

E. Evasion through Spurious Open-End Credit

In an attempt to protect against creditors evading the requirements of this rule, the Board is proposing to prohibit a creditor from structuring a home-secured loan as an open-end plan "to evade the requirements of this section."

As noted above, we believe it is appropriate that open-end credit transactions (HELOCs) are excluded from the coverage of this proposal. This is because, as the Board has noted, most HELOCs are held in portfolio; Regulation Z already provides special protections for HELOCs, such as restrictions on changing the terms; and HELOCs tend to be originated by federal financial institutions that are regulated and examined by the federal regulatory agencies, where they can be closely supervised and monitored for disclosure and underwriting.

Concern about "spurious" open end credit goes back to the earliest days of Truth in Lending. [8] In 1980, Congress amended the definition of open-end credit to tighten the requirements, effectively making it harder for creditors to evade the closed end credit disclosure requirements (if indeed that is what they were doing). The revised definition requires that creditors "reasonably contemplate" repeated transactions in order to be treated as open end credit. Any credit transaction that does not meet the test is considered closed end credit for purposes of TILA and Regulation Z.

We are not aware that this test has been inadequate to prevent creditors from engaging in spurious transactions in order to avoid closed end disclosures; and we do not believe any new or different rule is required to prevent such evasion under the proposed treatment of higher-priced mortgage loans. Introduction of a new legal concept is more likely to lead to confusion and further litigation.

We suggest that the Board monitor the issue after the rule is finalized, and only implement a change if necessary.

III. Proposed Rules for Mortgage Loans

A. Creditor Payments to Mortgage Brokers – Sec. 226.36(a)

1. General

The Proposal goes beyond the issues that were initially raised in the HOEPA requests for comment by including a proposed treatment for the regulation of mortgage broker compensation—notably the common form of compensation known as yield spread premiums (YSP). The Board defines YSP as "the present dollar value of the difference between the lowest interest rate the wholesale lender would have accepted on a particular transaction and the interest rate the broker actually obtained for the lender." This form of compensation can provide a benefit to consumers by allowing them to pay for at least a part of the broker's services through higher interest rates rather than an up-front payment. At the same time, as the Board notes, the relationship of the YSP to the rate that is obtained is not always apparent to the consumer. Consumers who may rely on a broker to find the "best rate" available, may not be aware of the broker's incentive to obtain a higher rate.

The Board's proposal neither bans YSPs outright, nor simply mandates a disclosure by the broker. Rather, it prohibits a creditor from paying a mortgage broker unless the payment does not exceed a dollar amount the broker has agreed with the consumer in advance will be the broker's total compensation. The restricted amount is limited to what the broker retains, rather than payments that may be distributed to other settlement service providers. The agreement between the broker and the consumer must disclose that the consumer will pay the entire compensation even if all or part is paid directly by the creditor, and that a creditor's payment to a broker can influence the broker to offer the

[8] See Rohner & Miller, Truth in Lending, 248-249 (2000)

consumer loan terms or products that are not in the consumer's interest or are not the most favorable the consumer could obtain. The broker must enter into the agreement before the consumer has paid a fee to any person or submitted a written application to the broker, whichever is earlier. Model disclosure language would be provided in the Regulation Z Commentary.

The proposed treatment of mortgage broker compensation is not restricted to higher-priced mortgages. It would apply to any closed end loan covered by TILA and secured by the consumer's principal dwelling.

2. Coverage of Mortgage Broker Compensation

CBA supports expanding and clarifying the disclosures of mortgage broker's compensation. As noted below, we would wish to see a better coordination between the Board and HUD, which administers the Real Estate Settlement Procedures Act (RESPA).

We also support the Board's approach to differentiating between mortgage brokers and the employees of lenders. The Board defines a mortgage broker for this purpose as "a person, other than a creditor's employee, who for monetary gain arranges, negotiates, or otherwise obtains an extension of credit for a consumer." Such a person would be a broker regardless of whether the credit obligation was initially payable to the person, unless the person funded the transaction from its own resources, from deposits, or from a "bona fide warehouse line of credit." Unlike independent brokers, employees of creditors do not hold themselves out, nor are they perceived by consumers, as trusted, or even disinterested, advisors who will find the best available rate from a wide variety of sources. Therefore, there is not the need for the same coverage. Further, as a practical matter, creditors' employees do not have the information needed to provide the disclosures, as they may not even know whether the loan will be sold on the secondary market.

We would appreciate the Board clarifying how one distinguishes a *bona fide* warehouse line from any other. In the alternative, we would recommend deleting the qualifier.

3. Timing of Agreement

The broker agreement must be entered into before the consumer has paid a fee to any person or submitted a written application to the broker, whichever is earlier. The purpose of the early timing requirement is to permit consumers to understand the relationship between fee and the rate early enough to be of use in shopping for credit, and before they are "locked in" by the payment of a fee.

However, the proposal requires that the agreement state a total dollar amount. Since it does not prohibit a broker compensation that is determined by reference to the rate or the loan amount, and those figures can vary up to the time of loan closing, the early disclosure often cannot be given with any certainty.

The Board alludes to this dilemma, and notes that it may lead brokers to price their services less efficiently, spreading the uncertainty through average cost pricing. We agree. However, whether the benefit of increased transparency outweighs this problem—as the Board believes-- may depend on how the regulation mandates the disclosure be provided. If a flat fee must be provided, and must be accurate, at such an early stage in the process, brokers will inevitably charge a higher fee to cover the risk of rate or price increases. We recommend that the Board consider ways to mitigate this problem; for example, by allowing for the disclosure to be provided as a range of amounts, or a percent.

In any case, the Board should permit a redisclosure, without liability, in the event that the fee amount changes due to events outside of the broker's control. In addition, there should be a reasonable tolerance for the amount of the broker fee, similar to the tolerance for the finance charge disclosure.

4. Mandating broker compliance

The proposal gives the creditor the responsibility for monitoring compliance, and it is the creditor who bears the liability under TILA. According to the Board, this is intended to be "a minimal compliance burden." A creditor demonstrates compliance by obtaining a copy of a timely executed broker-consumer agreement and ensuring that it did not pay the broker more than the amount stated in the agreement, reduced by any amount paid directly by the consumer.

We believe this is the continuation of an undesirable trend by regulatory agencies to place the compliance liability on creditors for obligations that belong more properly with the third parties with whom they do business. If the broker has the responsibility to provide disclosure to the consumer, the broker should be liable for failing to do so.

However, even if it is not within the Board's authority to impose liability directly on brokers under TILA, we believe that the level of broker compliance would be enhanced if the Board placed direct obligations on brokers in addition to the responsibility it places on creditors to comply.

5. Minimizing compliance burdens on creditors

We appreciate the Board's effort to keep the creditor's compliance burden to a minimum; however, we wish to suggest several ways in which that might be furthered.

- The Board needs to provide a model form of agreement that it either mandates for use by brokers or, at the very least, that provides a safe harbor for creditors and brokers. Model disclosures, which might be used by brokers in different ways in different forms, will not provide enough standardization to make compliance feasible for creditors or fee disclosures transparent for consumers. As noted below, the form should also satisfy the RESPA requirement in this area, so that there is less consumer confusion. We encourage the Board to make use of consumer testing to determine if this is clear and understandable, and to make whatever changes are necessary, while satisfying the need for a form that keeps compliance burdens to a minimum. A number of our member banks have been working to develop a good, working model of an agreement that they believe to be consumer-friendly and comparatively free from compliance problems. CBA along with these and other member banks would be happy to work with the Board in this effort.

- Because the lender must verify when the application was submitted to the broker and that the agreement was entered into before any fee was paid, the Board should require that the agreement be signed and dated by the consumer and that it contain an acknowledgment by the consumer that no fee has been paid. Creditors should be permitted to rely on the time in the agreement and the consumer's acknowledgment, as they have no direct contact with the consumer.

- The proposal prohibits a creditor from paying a mortgage broker unless the payment does not exceed a dollar amount the broker has agreed with the consumer in advance will be the broker's total compensation. The restricted amount, however, is limited to what the broker retains, rather than payments that may be distributed to other settlement service providers. There is no obvious way for the creditor to know what portion of the fees is being retained, and what portion is being paid to third parties. Therefore, we suggest that the agreement be required to include only the compensation to be retained by the broker.

- The Proposal obviously contemplates compensation that varies by rate or loan amount. Yet it does not provide an acceptable approach for compliance when the rate may change prior to rate lock or the loan amount may change prior to closing. The agreement should be permitted to state that the compensation amount is conditioned upon either the rate or the requested loan amount and that it may be subject to change. Brokers should be permitted to renegotiate the amount of the total compensation in such cases, and creditors should be permitted to accept amended agreements.

6. Safe Harbors

The proposal provides two alternatives that are available to creditors. One is where a state statute or regulation (a) expressly prohibits the broker from being compensated in a manner that would influence a broker to offer loan products or terms not in the consumer's interest or not the most favorable the consumer could obtain; and (b) requires that the broker provide consumers with a written agreement that includes a description of the broker's role in the transaction and the broker's relationship to the consumer. The supplementary information provides as an example a state statute that imposes a fiduciary obligation on a mortgage broker and requires the broker to disclose the obligation in an agreement with the consumer.

Although the Board refers to this as a "safe harbor," it is hard to see how a creditor or a broker can determine what state laws meet this complex and vaguely defined standard. It also forces creditors, when dealing with brokers that have not complied with the TILA rule, to make a legal determination that the broker's state requirement is adequate to pass muster under the safe harbor. An incorrect determination would result in liability under the Board's regulation.

The need for uniformity and a national standard of broker fee disclosures is critical for the consumer, whom we are trying to encourage to shop for the best credit terms, and the creditor, who is dealing with myriad independent brokers in multiple states. Although TILA's preemption standard only preempts state laws that conflict, it would at least require that all brokers comply with this one requirement, whatever else they would have to do under state law. Consumers may get too many disclosures, but at least we would be confident that one of the ones they get from every broker would be uniform. This alternative would undermine that benefit. We would therefore recommend that it be eliminated.

If the Board chooses to retain it, however, we suggest that the Board put in place a process whereby the Board would make a determination regarding state statutes and regulations upon request and publish the results, in order to reduce the compliance burden and risk of the "safe harbor."

7. Coordination among agencies

The RESPA Good Faith Estimate (GFE) and HUD-1 forms have historically been the vehicle for disclosing settlement costs and broker fees. We entirely agree with those who argue that the current form of disclosure of broker compensation is lacking. HUD has issued a proposal that attempts to redress this inadequacy through amendments to Regulation X.

The Board is aware of HUD's proposal. In the Supplementary Information, it states:

> The Board intends that its proposal would complement any proposal by HUD and operate in combination with that proposal to meet the agencies' shared objectives of fair and transparent markets for mortgage loans and for mortgage brokerage services. The Board and HUD have discussed their mutual desire and intention to work together to achieve these objectives while minimizing any duplication between their regulations.

Unfortunately, HUD's proposed revisions to the GFE, issued after the Board's proposal, take a totally different approach to the disclosure of broker compensation. If they do not actually conflict (that is, to the extent that a broker can comply with both), they are so totally at odds in style, content and timing, that if they were both to be adopted they would be a compliance nightmare for originators and valueless for consumers.

As you can see from the side-by-side below, the difference between these disclosures, as proposed, is profound:

TILA/HOEPA Proposal	RESPA Proposal
Disclosure must be in the form of an agreement between the mortgage broker and the consumer.	Disclosure included in a standard GFE Form
Disclosure must be prominently placed on first page of contract	Disclosure on page 2 of 4-page GFE form
Disclosure must be provided before the earlier of a written application or the payment of a fee.	GFE form must be provided within 3 days of receiving a "GFE Application" (which may be oral), consisting of information necessary to arrive at a preliminary credit decision.
The agreement must include: The total amount of compensation received by the broker, as a dollar amount; That the consumer will pay the entire amount of compensation that the mortgage broker will receive and retain, even if all or part is paid directly by the creditor, because the creditor recovers such payments through a higher interest rate; and That creditor payment to a mortgage broker can influence the broker in ways that are not in the consumer's interest.	Creditor charges and broker compensation are stated as a single "Service Charge." YSP payments are shown as a credit reducing the amount of the Service Charge. There is no separate disclosure of total broker compensation, nor of the fact that credit to the consumer is due to a payment by the creditor, nor is there a disclosure that such payments may influence the broker in ways that are not in the consumer's interest. Three disclosures appear sequentially: "Our Service Charge," "Your credit or charge for the specific interest rate chosen (points)" and "Your Adjusted Origination Charges." There is a box to check if Our Service Charge includes the credit or charge for the interest rate chosen.

Also, the TILA/HOEPA proposal would be limited to loans secured by the consumer's principal dwelling, and contemplates exemptions for certain state laws and compensation not determined by reference to the rate. The RESPA proposal, on the other hand, is not limited to the consumer's principal dwelling and does not contain such exemptions.

We recommend that the Board work closely with HUD to ensure that one set of disclosures can be provided giving the necessary information to consumers and minimizing the compliance burden for lenders and brokers. We believe that the Board's approach is far preferable to the one being proposed by HUD, which we find confusing.

In addition, the Office of the Comptroller of the Currency (OCC) requires in Advisory Letter AL 2003-3 that mortgage brokers working with national banks and their operating subsidiaries provide a mortgage broker fee agreement. The OCC's expectations are similar, but not identical to the Proposal in content and timing. We strongly encourage the Board to include the OCC in its deliberations leading up to any final regulations.

8. Liability

As we have also noted elsewhere, we believe the liability provisions under HOEPA are excessive and will encourage frivolous litigation. We recommend that the Board promulgate the requirement under its authority granted by section 105(a) rather than section 129(l). The stated purpose of the Board's rule writing authority under section 105 is to provide consumers with information needed to compare credit terms when shopping for credit.[9] This is precisely the underlying reason for this provision. The liability under section 130 for violations of rules promulgated under section 105(a) of TILA would be more than adequate to protect consumers.

We also recommend that a meaningful pattern or practice requirement be added to this provision. Given the millions of transactions entered into by creditors and brokers, and the difficulty of monitoring brokers for compliance, the opportunity for errors is too great otherwise. Any creditor that makes a practice of violating this section or has an inadequate compliance regimen would in any case be liable to individuals or classes of aggrieved consumers.

B. Coercion of Appraisers

The Board is proposing —in the case of all consumer credit transactions secured by a principal dwelling—to prohibit creditors and mortgage brokers from coercing appraisers to misrepresent the value of a consumer's principal dwelling; and to prohibit creditors from extending credit when creditors know or have reason to know, at or before loan consummation, that an appraiser has misstated the value of the dwelling.

In general, we are supportive of the Board's efforts to prevent creditors from pressuring appraisers in any manner. The Board should be mindful of the guidelines that already apply to federally regulated financial institutions. Issued in 2003, these interagency guidelines were designed to ensure the ongoing independence of the appraisal process. The guidelines remind banks that the bank's board of directors is responsible for ensuring that policies and procedures are adopted that establish an effective, independent real estate appraisal and evaluation process for all lending functions. Key to the process is the independent selection of qualified and experienced individuals to appraise or evaluate

[9] "The Board shall prescribe regulations to carry out the purposes of this title." TILA sec. 105(a). One of the purposes of the title, as stated in section 102(a), is the following: "It is the purpose of this title to assure a meaningful disclosure of credit terms so that the consumer will be able to compare more readily the various credit terms available to him and avoid the uninformed use of credit."

real estate. The guidelines stress that the individuals selected must be independent of the transaction and not subject to external or internal pressure. In addition, a qualified person not involved in loan production should review the reports.[10]

Since the time of the Board issuing the Proposal, the New York Attorney General has entered into agreements with Fannie Mae and Freddie Mac regarding their policies on purchasing mortgages, which would restrict the appraisal practices of the lenders from whom they purchase. The GSEs are requesting comment on their new guidelines from lenders, and we will be sharing our views.

Our biggest concern with the Proposal is the phrase "knew or had reason to know." We are not convinced that this phrase will prevent lenders from being the subject of nuisance litigation. The real issue is whether the creditor has actual knowledge about the misstatement. Creditors have limited ability to detect undue influence from third parties. The responsibility should lie with the parties involved, including the appraisers, who have their own professional standards and ought to have some accountability.

C. Servicing Abuses

The Board is proposing to prohibit certain practices on the part of servicers of closed-end consumer credit transactions secured by the consumer's principal dwelling. These would prohibit the following:

(1) Failure to credit a periodic payment as of the date received;
(2) "Pyramiding" late fees;
(3) Failure to provide a schedule of fees and charges upon request; and
(4) Failure to provide a payoff statement upon request

The Board is concerned that there may be insufficient market pressure on servicers to ensure that competitive practices either protect the consumers from abuse or provide sufficient transparency.

We support the attempt to provide better regulation of servicers to prevent abuse and protect consumers. Our primary concern with these proposals is the extreme liability that would attend even minor violations of the occasional variety. Many servicers handle hundreds of thousands of customer accounts and despite best efforts, to take but one example, may not always provide a payoff statement as promptly as every consumer would like. The draconian result just under the section 129 penalties could be the loss of all finance charges and fees paid on the loan.

As with so many other provisions in this Proposal, we believe that the Board needs to ensure that minor technical violations do not result in the excessive liability associated with violations of TILA section 129(l). One possible approach would be to adopt a requirement of a "pattern or practice," as the Board is proposing for the ability to repay

[10] OCC Advisory Letter AL 2003-9. http://www.occ.treas.gov/ftp/advisory/2003-9a.pdf

requirement. Without some protections, creditors will be faced with a huge volume of frivolous and costly law suits.

In particular, in regard to the requirement to provide a schedule of fees and charges, we support the principle that consumers be provided with clear and accurate disclosures of fees that may be charged in connection with the servicing of the account. However, instead of a mandate to provide a schedule upon request, we recommend a prohibition against inaccurate or misleading fee disclosures. We believe most creditors provide a fee schedule through a variety of means—on line, in monthly statements, and upon request either as a complete schedule or for individual ancillary services. A regulatory mandate to provide a schedule upon request is likely to result in the potential for numerous, minor technical violations leading to excessive liability. Numerous questions immediately come to mind: Which fees should be included and which not? What about a third-party pass-thru fees? What should creditors do about default- or collection-related fees that are regulated by state law and subject to judicial approval? Would a routine, monthly statement of fees satisfy the requirement?

D. Other Potential Concerns - High-Cost ("HOEPA") Loans

The Board seeks comment on whether the numerous other provisions applicable to High-Cost Mortgages under section 226.32 of Regulation Z ought to be extended to higher-priced mortgage loans. These include restrictions on negative amortization, interest rate increased on default, balloon payments on loans with terms less than five years, prepaid payments, direct payments to home improvement contractors without written consent, due-on-demand clauses, and refinancings by the same creditor or an assignee within one year unless it is in the borrower's interest.

We believe that the Board's approach—to focus on the most important considerations in a targeted way rather than scattering shot in all directions—will be more effective while imposing fewer burdens on the industry. We do not believe that there is a need for these restrictions to apply outside of the realm of the High-Cost Loans.

E. Advertising

The Board is proposing many changes regarding advertising of home equity lines of credit under section 226.16 of Regulation Z and closed-end credit secured by a dwelling under section 226.24.

We agree on the need for improvements in the advertising requirements related to real-estate secured lending; however, we suggest that the Board undertake further consumer testing of advertising information before promulgating rules. The Board has begun the process of open- and closed-end review of TILA, and both can be the vehicles for addressing the advertising requirements.

We note with appreciation that the Board has stated: "This [advertising] proposal is made under the Board's general authority to adopt regulations to ensure consumers are informed about and can shop for credit. TILA Section 105(a), 15 U.S.C. 1604(a)." The issue of the authorization is not merely academic, as we have noted elsewhere, since it can have a significant effect on liability and enforcement.

However, the Board has singled out seven proposed practices as being unfair or deceptive practices, and thus subject to rulemaking under the Board's authority in TILA Section 129(l)(2), 15 U.S.C. 1639(l)(2). For these practices, the Board should recognize that the technical and detailed formatting requirements concerning the advertising of fixed/adjustable rates and advertisements of comparisons could easily give rise to technical, inadvertent violations where there was no intent to mislead the consumer, and where no one is in fact misled. The penalties under section 129 are grossly disproportionate to the violation.

IV. Early Mortgage Loan Disclosures

The Board proposes to expand the early disclosure requirement of the primary closed-end Regulation Z disclosures that currently applies only to "residential mortgage transactions" (essentially purchase-money mortgages) secured by the consumer's principal dwelling and subject to RESPA. As proposed, the early disclosure requirement would apply to other types of closed-end mortgage transactions if they are secured by the consumer's principal dwelling, including refinancing, home equity loans and reverse mortgages.

The early timing requirement calls for a good faith estimate of the Regulation Z disclosures to be delivered or placed in the mail not later than three business days after the creditor receives the consumer's written application. The Board is also proposing to add a requirement that the early disclosures be delivered before the consumer pays a fee to any person for the transaction. However, the Board is proposing an exception to the fee restriction for bona fide and reasonable fees to obtain a credit report.

We generally support the extension of the early timing requirement to other mortgage loans secured by a consumer's principal dwelling. Our principal concern is with the Board's proposed requirement that the disclosures be provided before the consumer pays a fee to any person. The inability to charge a fee at application can prove detrimental to consumers. When consumers are attempting to refinance or obtain a loan at the lowest possible rate in a rising interest rate environment, for example, creditors would not be able to charge a rate-lock fee at application. In general, the requirement would delay closings, as creditors may be unable to begin processing loan applications for several days. We recommend that the Board reconsider this proposed change.

V. Effective Date

We recommend that the Board adopt a two-tiered effective date.

For most of the proposed changes, we recommend an effective date that is the October 1 which follows by at least six months the date of promulgation. Even lenders who do not intend to make higher-priced loans will need to ensure that they have systems in place to keep their loan rates below the trigger, and will further have to make whatever changes are necessary to comply with any new requirements under section 226.36. There will also be training required for loan origination and advertising.

We believe that the escrow requirements and the early disclosures require a longer lead time. Both of these changes will require many lenders to create systems for the first time which will be particularly difficult and time-consuming to implement. Therefore, we recommend at least 24 months lead time for these changes.

# # #

Thank you for the opportunity to comment on this rulemaking. If you have any questions or wish to follow up, feel free to contact me directly at (703) 276-3871, or at szeisel@cbanet.org.

Sincerely,
/s/
Steven Zeisel
Senior Counsel